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FAR EAST/PACIFIC BRANCH
OFFICE OF REPORTS AND ESTIMATES
CENTRAL INTELLIGENCE AGENCY

WORKING PAPER

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FAR EAST/PACIFIC BRANCH

INTELLIGENCE HIGHLIGHTS NO. 34
5 January - 11 January 1949

SECTION I. SUMMARY OF FAR EAST TRENDS AND DEVELOPMENTS

The Asian Conference which is scheduled to convene in India on 20 January to discuss the Indonesian situation is expected to become an anti-colonial rally (page 3).

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25X6 [REDACTED] USSR attacks in the Far Eastern Council (on labor policies) and in the Allied Council for Japan (on military revival) were rebuffed. However, similar Soviet propaganda efforts will continue (page 5).

In North Korea, an agreement to build naval bases for the USSR is reported (page 5) and an uprising of dissidents is scheduled for mid-January (page 6). South Korea's President Rhee will probably dump Prime Minister Lee Bum Suk, despite official denials. A "suitable" replacement may be the first step towards gaining Kim Koo's support of the Government (page 6). Meanwhile, US observers report that the Coast Guard must substantially strengthened in order to halt smuggling of rice out of Korea (page 7).

This week, the Communists warned FU Tso-yi's troops to surrender or die and then resumed their military operations, assaulting Tientsin in the north and wiping out the remnants of TU Yu-sing's forces in Central China (page 8). Meanwhile, the Communist reaffirmed their refusal to compromise with the Kuomintang (page 8) and CHIANG Kai-shek's regime called for four-power mediation and made plans for flight to Taiwan (page 9).

Philippine President Quirino is considering a trip to the US (page 11). Refugees now arriving in the Philippines from China will be housed at former US naval base; the Philippine Government is likely to request US assistance in order to maintain them (page 11).

The marginal notations used in succeeding sections of this Weekly ("A", "B" or "C") indicate the importance of the items in R/FE opinion with "A" representing the most important.

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The massacre of Karens in Burma may precipitate widespread communal warfare (page 11).

In Siam the Phibul Government continues in its trend toward economic nationalism (page 12).

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SECTION II. DEVELOPMENTS IN SPECIFIED AREAS

GENERAL

Asian Conference expected to become an anti-colonial rally

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The India-sponsored Asian Conference is now scheduled to convene to consider the Indonesian question in New Delhi on 20 January. Although enthusiastically welcomed by nearly all countries involved, there is no strong indication that the conference will produce any immediate threats to Dutch plans in Indonesia. Fifteen countries (Pakistan, Egypt, Lebanon, Syria, Saudi Arabia, Iraq, Trans-Jordan, Yemen, Burma, Philippines, Australia, New Zealand, Afghanistan, Iran, and Ceylon) have accepted Nehru's invitation to attend the conference. Siam and Turkey have refused attendance on the grounds that the problem can best be handled in the UN. No answer has yet been received from Ethiopia, while China is sending only an observer. Since the conference was called hurriedly, it is doubtful whether any clear-cut, carefully considered agenda will be presented to the delegates. The conference is likely to recommend several measures--including economic sanctions--designed to hamper the Dutch. However, the denial of airfields and ports in India, Pakistan, Ceylon and Burma to the Dutch--already in effect--appears to be the most effective and feasible sanction at the moment. Material or military aid may be proposed. Such aid, even if it could be afforded and transported to Indonesia by the countries concerned, would be countered by the Dutch blockade and, if necessary, by Dutch military action. There has been considerable speculation about the emergence of a strong continuing Asian bloc, but divergence of interests among the countries involved, and their previously demonstrated coolness to Indian leadership and the absence of sufficient means of enforcement will limit such a development in the immediate future.

The conference may go so far as to draft a plan for Indonesian independence to be forwarded to the Security Council. In any event, it is expected that the conference will develop into a general anti-colonial rally. Despite vigorous US efforts to clarify its position on the Indonesian question which have met with some success, the US will not escape considerable criticism on the grounds that it indirectly supported Dutch colonial interests. The ill will engendered will make it more difficult for the US to maintain a favorable position in Asia. It is not expected that there will be any friendly move toward the USSR on the part of the conference members. However, any serious cleavage between Asia and the West and the development of a situation favorable to Soviet propaganda will be thoroughly exploited by the USSR.

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JAPAN (Cont.)

USSR continues attack on US Japan Policy. The USSR's intensifying program vis-a-vis Japan materialized within the past week before the Far Eastern Commission (FEC) and the Allied Council for Japan (ACJ). On 6 January, the FEC in closed session at Washington voted down by an overwhelming majority the USSR's resolution to condemn the Japanese Government's recent law prohibiting strikes and collective bargaining by government workers. USSR Ambassador Panyushkin promptly produced a prepared statement censuring other nations for approving these "anti-democratic" measures. Other FEC representatives indicated their vote was not so much an endorsement of current labor legislation as a rejection of Soviet tactics.

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In view of the public censuring of the USSR by the other 10 members of the FEC last December for breaking the secrecy rules governing their proceedings, Panyushkin's immediate release to the press of his condemnation of the FEC Decision is noteworthy and further indicates that the USSR's tactic was primarily propaganda.

On 4 January at the ACJ meeting in Tokyo, General Derevyanko, Soviet member, charged that the US is permitting revival of the Japanese Army through the expansion and militarization of the present police establishment. Point by point, US member Sebald refuted the Soviet charges, characterized them as propaganda and added that no army could be organized on such a decentralized framework as the Japanese police system now possesses.

At the international level, Soviet policy towards Japan, despite rebuffs, continues to call for propaganda which labels the US as a "warmonger" and is intended to embarrass Occupation policy. (See E/FE Weekly 10-16 November.)

KOREA

The first indication that the USSR intends to maintain naval bases in North Korea has been received. The terms of a treaty, reportedly concluded by Kim Il Sung with the Soviet Union, provide that North Korea will render support to the Soviet Pacific fleet by furnishing naval bases. Construction work necessary for the development of port facilities at Chongjin, Wonsan and Yongchung Bay (all on the east coast) is expected to begin during March 1949, using Korean labor under the direction of Soviet engineers. Propaganda will be issued in advance of construction work to the effect that the Soviet Union is helping the Korean people develop their harbors.

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KOREA (Cont.)

Organized revolts in North Korea, involving armed dissidents of the People's Army Coast Guard in Hwanghae Province, are scheduled to break out in mid-January, according to a detailed operational plan recently seen by a US observer. (See B/FE, 10-16 November 1948). According to the plan, successful, simultaneous attacks on public installations in Sariwon, Chaeryong and Haeju (NE of 38th parallel), coordinated with support from a disaffected Coast Guard vessel that will move from Chinnampo to Haeju, is to be followed by establishment of guerrilla headquarters in the mountains near Haeju and Hwangju. According to a Korean source, a single direct bid by these dissidents for South Korean support was turned down by Lee Bum Suk, Prime Minister of South Korea on 1 January 1949. Lee decided, however, to send an observer when told that the plans would proceed in any case.

"B"

It is certain that dissatisfaction in North Korea exists and is increasing. Soviet withdrawal may afford dissident elements the opportunity to organize and expand. An uprising at this time, however, has only a meager chance for success against the tight police control which has been established in North Korea. A disturbance in North Korea so close upon the heels of Soviet troop evacuation would be of the highest propaganda value to South Korea but would also aggravate an already sensitive situation along the 38th parallel.

Cabinet shuffle likely. President Rhee has publicly refuted rumors of an impending shuffle of his cabinet and has branded as "groundless talk" reports of a rift between him and Prime Minister Lee Bum Suk. Despite Rhee's denial, he probably will make additional cabinet changes, including the removal of Lee who has built a strong personal following among Korean youth in opposition to Rhee's plans to unite all rightist youth in a "non-political nation defending" organization under his own leadership.

"B"

Rhee may appoint as Prime Minister a personal friend and follower such as Shin Suk Woo or Shin Ik Hi. However, more probably Rhee will effect a Cabinet shuffle to meet the minimum demands of the Assembly's uneasy coalition of rightist and moderate factions which has the capability of curbing Rhee's broad constitutional powers. They are urging a rapprochement between Rhee and the Kim Koo-Kim Kiusic political elements in order to increase popular support of the Republic. It can be presumed that Kim Koo now is prepared to swing his considerable prestige and following behind the Government if he is offered a high position and his action is not represented as a surrender to Rhee. The appointment of Cho So Ang, Lee Chung Chum, or Kim Sung Soo as Prime Minister would mark the first step by Rhee in effecting eventual collaboration with Kim Koo and Kim Kiusic.

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KOREA (Cont.)

Coast Guard ineffective. US Special Representative Muccio is concerned over the under-developed status of the Korean Coast Guard (Navy). This arm of the Korean security forces is relatively neglected and possesses virtually no vessels or equipment. Due to the Coast Guard's inability to patrol the long coast line effectively, large quantities of rice are being smuggled out to Japan and North China, jeopardizing the rice program and the relatively favorable food situation. In addition, sea-borne smuggling trade with North Korea and North China is an important source of revenue for Communists in South Korea. Although it would be impossible to stop all smuggling, an effective Coast Guard equipped with suitable small craft and auxiliary equipment could reduce it to a minimum.

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CHINACommunists issue ultimatum to FU Tso-yi and resume military activity. "A"

The Communist North Shensi radio has broadcast a message, signed by General LIN Piao and his political commissioner, LO Jung-huan to all Nationalist generals defending North China, warning them that the Communists are about to launch a general offensive in the area and calling upon all generals to surrender their forces at once and "escape the fate of destruction." The Communist radio jeered at their hopes of assistance from the US or from Nanking, the latter being "too much occupied with saving" itself. Pointing out that certain lessons are to be derived from the fate suffered by the encircled forces at Kalgan and Hsuehou, the broadcast urged all commanders to "follow the example" of CHENG Tung-kuo, who turned over to the Communists at Changchun. The radio advised that if "all arms, assets, warehouses, and industrial and communications equipment" are transferred intact, the officers will "be accorded lenient treatment." For the third time the Communists admitted that FU Tso-yi, while high on their list of war criminals, could still "atone" for his "past crimes" through the performance of "meritorious services," defined as the immediate surrender of his entire force. Following close on the heels of this warning, and undoubtedly in an effort to assist FU in making up his mind whether to fight or surrender, the forces of Communist General LIN Piao, after being replaced by NIEH Jung-chen's columns from Kalgan, moved from the Peiping encirclement to assist in the assault on Tientsin. The capitulation of this North China industrial hub is expected in the next few days.

Meanwhile, in Central China, the remnants of TU Yu-ming's encircled army groups have been wiped out and Communist forces in this area are moving into position for their drive to the Yangtze.

Chinese Communists reaffirm refusal to compromise with Kuomintang. "B"

Several broadcasts from Chinese Communist Party headquarters in the past 10 days have attempted to justify the Communists' rejection of not only the recent but also any future Nationalist peace proposal. The broadcasts state that "Chinese reactionaries" and "American imperialists" have a double program: (a) militarily, "to organize remnants of Kuomintang military strength...to continue resistance south of the Yangtze and in distant border provinces..."; and (b) politically, to concoct "peace plots," and "to organize opposition within the revolutionary camp," in order "to halt the revolution or to make it take on a moderate coloring." (The Communist Party asserts that "British and French imperialists support this policy of American imperialism." The British have in fact been helpful to the Communists, in affording sanctuary to a number of its leaders and allies in Hong Kong, and the French have been inactive in China, but this Communist assertion is useful now in supporting Soviet foreign policy and will perhaps be useful

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later in regard to Communist intentions toward Hong Kong and Indo-China.) The Communist broadcasts repeat the "war criminal" list, state that "every one of these vicious bandits is inseparable from American imperialism," and declare flatly that the Communists will not compromise with or show mercy to such persons. The Nationalist peace proposal is regarded as an attempt: (a) "to preserve the interests of the Four Families...and American special privileges" and, (b) to gain time for the Kuomintang to "stage a comeback and destroy the revolution." The revolution therefore demands "the thorough destruction of all reactionary forces and the expulsion of American aggression."

While these remarks have been attributed by the Communist Party only to its lesser officials and organs, rather than to the Central Committee, and therefore do not preclude negotiations, they make it clear that the results of any negotiations would not differ significantly from the results of a continued Communist military offensive. These results will probably be: (a) a Communist-controlled government for all of China, under a Soviet-style constitution, and open only to persons willing to accept the dictation of the Communist Party; (b) the destruction of the Kuomintang as a political party, and the exclusion from the new government of almost all of its leading figures; (c) the replacement of the US by the USSR as the dominant foreign influence in China, perhaps with a Sino-Soviet military alliance; and, (d) in time the extension throughout China of the type of society which now prevails in areas occupied by the Communists.

China's request for four-power mediation of the civil war, in part an effort by the National Government to play for time and to avoid direct negotiation with and surrender to the Communists, is yet at the same time an attempt to meet the growing demands for peace. The Big Four, however, will probably be reluctant to accept the responsibility for ending the civil war. Though made in the name of the National Government, the mediation request probably reflects in particular the efforts of a small group in the Government headed by CHIANG Kai-shek. Pressures from both within and without the Government demanding peace and CHIANG's retirement have continued to grow to such proportions, since the Generalissimo's bid at the beginning of the new year for peace at "his price," that it is unlikely either the people or the troops can be persuaded to back a continuation of the war. Although earlier, CHIANG has seemed prepared to retire in the near future in favor of LI Tsung-jen, Communist intransigence in response to the Generalissimo's peace bid has sharpened his decision to continue resistance. CHIANG's apparent change of mind undermines the efforts of the peace-seeking members of the Government, leaving them for the time being powerless to act, while CHIANG makes further preparations to continue direction of a rump government from Taiwan.

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Taiwan becoming National Government stronghold. Taiwan's new Governor, CHEN Cheng, has stated in the press that he will never allow Taiwan to be invaded by Communist forces or ideologies and that "we shall endeavor to make Taiwan the main fortress for the rejuvenation of the Chinese nation." Additional reports indicate that various National Government assets such as gold bars, factories, and technicians are being transferred to the island. Moreover, several thousand Nationalist troops reportedly have disembarked at Keelung. Privately CHEN has voiced concern over the problem of rehabilitating railroads and harbors, perhaps with a view to asking future US aid. Despite the lack of full international legal sanction for present Chinese control of Taiwan as well as the prospect that a Nationalist regime there might not obtain general international recognition with mainland China under a different government, CHIANG Kai-shek apparently hopes to exercise power in Taiwan indefinitely, continue his fight against the Communists from that locale, and eventually attempt restoration of his rule in China. "B"

Nationalist inflation reaches unparalleled heights. The Chinese Government is powerless to stop the unprecedented inflation which has been running wild for three weeks. The Government's resumption of gold sales at an "equalized" price approximating the black-market rate was the only economic measure undertaken last week. Gold is now reported to be over GY \$10,000 per ounce and the US dollar sells for more than GY \$200 on the black market. The traditional settlement of debts before Chinese New Year (January 28) is the only stabilizing influence in China's present rocketing inflation but its effect this year, in view of the pressure of the upward trend, will probably be small. "B"

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PHILIPPINES

President Quirino reported considering trip to US. The US Military Attache in Manila states that, according to recent local press reports, President Quirino will visit the US within the next few months to discuss Philippine rehabilitation and over-all defense relationships with the US. The local press suggests that a possible change in US defense policy may be under consideration and quotes "official sources" as stating that the Philippines may reorganize its army to conform with the shift in US planning. "B"

Philippine officials have shown growing concern over the Republic's strategic vulnerability in view of the China situation. The US Attache reports that there are increasing signs that the Philippine Government desires the closest military relationship with the US. In addition to real concern over the Philippine defense position, President Quirino probably believes that such a trip would have a salutary effect on his 1949 presidential campaign — particularly if he can point to success in obtaining further US financial aid for rehabilitation and veterans' benefits.

Considerable US assistance will probably be requested for refugees in the Philippines. The US is likely to be asked for considerable assistance in establishing and maintaining a camp at Guinan, Samar (a former US naval base) for an estimated 6,000 European refugees — mainly White Russians — who will soon begin arriving from Shanghai. Representatives of the International Refugee Organization (IRO) are preparing a request to be submitted to the US Army for camp equipment for the refugees who will be permitted to remain in the Philippines for four months. Philippine National Defense Headquarters, while planning security measures to restrict the refugees to the designated area, appears to be depending upon US agencies in Shanghai to provide information obtained by screening refugee lists. The US Military Attache in Manila anticipates that the US Army will be asked to assist appreciably in establishment of the Samar camp since no usable shelter is at present available. There remains the further possibility that the US may be asked to assist in maintaining security in the camp area since it is likely that Philippine officials don't want to shoulder such a responsibility alone. "B"

BURMA

Massacre of Karens may precipitate widespread communal warfare. Karen-Burman relations in Burma have been further strained, possibly to the breaking point, as a result of the massacre by socialist controlled police levies of at least 80 Karens attending Christmas Eve services at a village church in Mergui District in Southern Burma. Undoubtedly there were retaliations. Karen resistance throughout Burma has become increasingly evident, and they "A"

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BURMA (continued)

are reported attacking Government forces in some areas with the purpose of securing additional arms. Although Prime Minister Thakin Nu and Karen leaders appear eager to avoid communal strife, neither are capable of controlling their more extremist followers and the Mergui atrocity may prove to be the incident signalling the commencement of open warfare. Unfortunately, the major issue of whether or not the Karens are to have a separate state has not been resolved as both parties remain adamant in their position regarding the creation of such a state. At the moment the Karens are extremely anxious to present their case to the UN and foreign governments. Meanwhile, the Burmese press continues to accuse "Anglo-American imperialists" of aiding the Karens. For the moment, racial antagonisms appear greater than political differences, with the outbreak of communal violence promising to be more ferocious and destructive than any of the politically inspired insurrections now in progress.

SIAM

Phibul regime continues trend toward economic nationalism. The Siamese economy, although relatively stable and viable, is following the 1948 political pattern of centralization through the trend towards increasing controls by the national government. The economic nationalism of the Phibul regime is exhibited best by the increased economic and social restrictions placed upon the large Chinese minority which is a continuing source of irritation to the Siamese. Through the medium of a War Veteran's Organization, the Phibul regime has attempted to enter many of Siam's economic activities which are dominated by Chinese. Moreover, a Siamese Labor Union was activated under governmental sponsorship in competition with the strong and thoroughly Chinese dominated Central Labor Union. The Phibul government has enlarged its field of economic participation, additionally, by reactivating the Government Purchasing Bureau which is currently expanding its activities. A later indication of this economic trend is the recent establishment of import controls, aimed principally at luxury goods. The Siamese Government apparently considers that excessive foreign exchange is being dissipated through luxury purchases and has acted in an effort to conserve foreign exchange to be directed at the purchase of equipment for more productive purposes. Although not yet imposed, quota allocations and exchange controls are being considered and may be established to supplement and effectuate the import restrictions. The imposition of additional exchange controls probably would be strongly resisted by Siam's business community and would strengthen the reasons for smuggling which is currently widely practiced.

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SECTION III. DIGEST OF IMPORTANT STUDIES AND ESTIMATES

MONETARY UNIFICATION IN COMMUNIST CHINA

I. Present monetary system in Communist China.

Numerous currencies are being circulated in Communist China, and the fluctuating rates of exchange among them make their use cumbersome. Their circulation in rural areas is apparently small, since silver dollars, grain and other barter goods are preferred. Consequently, taxes are largely collected in kind by the Communists. However, taxes are unevenly applied and Communist broadcasts discussing land reform problems indicate that this is a serious problem. Communist banks in North China are independent units and are probably none too stable since, being agricultural institutions, they do not have the resources individually to withstand the calamities of frequent regional crop failures. Money, banking and taxation policies and practices in Communist-dominated China and Manchuria are almost completely unknown. Despite the announced establishment of a single Communist currency for all North China on 1 December, 1948, there has been no report of its issuance and the old currencies are still in use.

II. Obstacles to Communist exploitation of the disorganized Nationalist economy.

Since the decisions of industrialists, businessmen and the Government in Nationalist areas are dominated by short-run considerations, there has been little incentive to invest even in necessary factory repairs and upkeep. The result has been a continual contraction of industrial facilities. Central direction of industry cannot in practice be applied. For example, even a once efficient Government organization like the National Resources Commission has so changed in character that it is now composed of disconnected and competing units. Moneyed people in Nationalist China have engaged chiefly in such unproductive enterprises as speculation, smuggling and money dealing. The Government's tax machinery has largely broken down due to confusion among the numerous Government agencies empowered to collect taxes, to the physical inability of the Government to collect taxes from outlying regions and to widespread tax evasion. The existing framework in Nationalist areas is too inefficient and obsolete satisfactorily utilized by a successor regime.

III. Communist currency unification.

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The Communists have recognized the inadequacy of their own monetary systems and the undesirability of depending on the Nationalist financial system. Therefore, in anticipation of gaining control over all of China the Communists announced unification of the four currencies circulating in "liberated" China, and the merger of Communist banks in China into the People's Bank of China. The Communist broadcast stated that the geographical unification of the "liberated" areas and the resumption of interprovincial commerce have made necessary a single currency for all Communist China, excluding Manchuria. The Communists state that the new yuan will be backed by "grain, cotton, cloth" and other commodities rather than by "gold and silver." Apparently no objection to the use of silver dollars will be made, since the Communists claim there is sufficient silver in Communist areas. Likewise, "price ceilings" will be unnecessary because goods are available "in any market at any time."

Monetary unification seems to be a necessity for the Communists at this time chiefly because they have extended their political control over such a large area of China. Although the four or five economic regions throughout "liberated" China have been relatively independent of one another, continued economic autonomy would seriously hamper Communist political unification. The Communist action, in combining the four different currencies, should help considerably in integrating the economies of the region and will especially facilitate interprovincial trade.

In addition to consolidating areas already held, the immediate establishment of a central monetary system would expedite subsequent economic control over the large and complex Yangtze Delta and the Peiping-Tientsin industrial areas. As large cities come under Communist domination the need for central policies will be sharply evident. Since industries cannot be taxed in kind like farmers, an adequate monetary system and equitable commercial tax regulations will be needed. The supplying of Kailan coal to Shanghai exemplifies the interregional trade needed. The easy flow of commerce is possible only with a common currency and a unified banking system.

The Communists want to eliminate the gold yuan which is a symbol of the old order. In newly occupied areas they have first accepted it at greatly devalued rates and then rapidly replaced it. Also it is easy for a nationalized banking system to wipe out private investments by currency manipulation. The Communists are expected to undertake measures for this purpose.

IV. Acceptance and stability of the new currency.

The issuance of the new yuan can be simply accomplished by

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accepting it for taxes and selling government-controlled commodities (the Communists usually control the chief staples) in exchange for it. Nevertheless, there will be an initial desire of the Chinese people to use metallic money and a deeply ingrained distrust of any paper currency, no matter how stable or powerful the supporting government. This distrust will linger for a long time in rural areas and will require considerable "education" and enforcement to overcome.

The stability of the currency will be doubtful, for a conservative banking system cannot be expected from the Communists in the immediate future because, while inflation will not consciously be their purpose, the temptation to finance budget deficits by printing currency will be great. Currency manipulation is a popular Communist device to wipe out private investments and savings and, if attempted, will add to the instability of the currency. On the other hand the Communists may not be confronted with the excessively high velocity of currency (typified by the "buying sprees" periodically experienced in Nationalist cities), since greater political stability can be expected after the cessation of the civil war.

V. Exclusion of Manchuria.

The exclusion of Manchuria from the Communist currency unification is additional evidence of the separation of the North China and Manchuria governments, and the possible emergence of Manchuria as a Soviet-dominated "People's Republic." Lack of communications is a poor pretext as communications with Manchuria are certainly no worse than overland connections with Shensi and the Northwest. One obvious reason for the separation would seem to lie in the self-interest of the regime in Manchuria not to commit its economic resources to its much poorer and disorganized neighbor to the south.

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